Access to Legal Redress in an EU Investment Screening Mechanism

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A Common EU Law on Investment Screening Access to Legal Redress in an EU Investment Screening Mechanism
Teoman M. Hagemeyer Fr 8 Feb 2019

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The proposal for a regulation of the European Parliament and of the Council establishing a framework for screening of foreign direct investments into the European Union (Draft Proposal) presupposes (some would even say: proposes) investment screening and control mechanisms (ISCMs) at member state level. Approaching ISCMs from the angle of legal redress raises three questions:

1. Legal redress to what end?
2. Legal redress by who?
3. Legal redress by which material standards?

Sorting out these questions is of vital interest for stakeholders. For investors and their counsel confronted with a new layer of regulation and uncertainty, as much as for member states and the EU itself which have to make use of the ISCMs' powers without violating pertinent constitutional rights or fundamental freedoms.

To what end is legal redress sensible?

In most instances, compensation will take priority over actions for annulment of what the Draft Proposal refers to as *screening decision* relating to an investment. Isolated legal action against member state laws establishing ISCMs or against the Draft Proposal itself shall be omitted here, being onetime and longterm efforts.

Investment deals fall apart only on a whiff of regulatory encroachment. Experience with CFIUS and the German ISCM in the Aixtron takeover is only one illustration for this "power of fact": Public announcement of the German authorities to review the takeover (regarding German-based Aixtron SE) together with its partial prohibition by the US President (regarding the US-based subsidiary Aixtron Inc.) sealed the deal's fate. So, on the one hand, pending review of a particular investment suffices to scare investors to a degree that they withdraw from a takeover altogether. On the other hand, one should not forget that shareholders invested in the target company also face significant devaluation in consequence of pending review or withheld approval.

Against this background, how sensible is it to review a *screening decision* of an ISCM, i.e. the decision to initiate a review, to make a transaction contingent upon certain conditions or even to prohibit an investment altogether? Mildly so. Court cases take time, and even preliminary injunctions will overstrain the patience of the market. It seems unlikely that adjudication is a solid basis to save a deal that has (publicly) run into the prospect of review. This impression is reaffirmed by the fact that one lawsuit in one jurisdiction would often not be enough: In the Aixtron example, both the

prohibitive decision of the US as well as the (pending) decision of the German ISCM would have had to be subject to legal action. In addition, there was no decision by the German Federal Ministry for Economic Affairs (*BMWi)* to be dragged before court, only the prospect of one in the future. What should investors do here? Sue the administration for a (potentially dealkilling) decision? Again, only mildly sensible.

This is not to say that seeking legal redress against screening decisions is not possible or irrational per se (there may be sound legal reasons to do so), but it seems to be of little avail to actually save investments under review. Naturally, there are exceptions to the rule: For instance, the 2014 *Ralls* case, the only lawsuit involving the Committee on Foreign Investment in the US (CFIUS) in history. But the case involved a *divestment* decision by the US President, i.e. a situation where claimants were trying to save money *already invested*.

In most cases, however, the most sensible course of action for frustrated investors (or shareholders in the target company) seems to be to sue for damages due in consequence of a withheld, delayed or issued screening decision. Given the fragility of investments, it will also be interesting to see whether the (nominally innocent) opinions, comments and information requests provided for in the Draft Proposal will cause damage and entail litigation. In any case, legal action is dependent on whether screening decisions are reviewable or justiciable at all (and if yes: by who and by what standards).

Who can be called upon for legal redress?

It boils down to national and EU courts. Arbitral tribunals would have to rely on justiciable market access provisions, which are something of a rarity in the EU (and member state) bilateral investment treaty (BIT) tradition(s). Again, the exception to the rule is for investments already made, for which BITs will usually offer protection against divestment decisions by ISCMs.

Moving from state to supra and interstate level, from litigation to arbitration, the obvious fora are: member state courts, the *Court of Justice of the European Union* (CJEU) and arbitral institutions such as the International Centre for Settlement of Investment Disputes (ICSID). By comparison, calling upon the World Trade Organisation (WTO) Dispute Settlement Body would require a WTO member state to back its investors' interests and sue (Art. 1 (1) DSU). But since the General Agreement on Tariffs and Trade (GATT) has no and the General Agreement on Trade in Services (GATS) little material protection to offer to investors anyway, the WTO Dispute Settlement Body can be neglected, as previous cases have shown.

Member state courts, in Germany for example the Berlin administrative court (competent for legal actions against screening decisions made by the *BMWi*) and civil district courts (competent for damages claims), apply national law to national acts, such as a decision by German authorities or losses suffered as a consequence of such. Judges at the CJEU apply Art. 340 TFEU, which requires "damage caused by [the EU's] institutions or by its servants in the performance of their duties". ICSID and other arbitral institutions have never been shy to award compensation to investors for state

actions in violation of BITs; the EU's multilateral investment court could do the same in the future. However, both require market access provisions which investors can invoke; the emerging EU model BIT does offer such provisions, but, in contrast to typical US and Canadian BITs, they are not justiciable (for instance CETA, the EU-Vietnam FTA and the EUSingapore FTA).

What are the material criteria?

It is decisive to pinpoint the material standards for legal review. Every ISCM has to let investors know what its understanding of a *covered transaction* is (with interesting subquestions such as what are *foreign investors*, *critical industries and infrastructure* etc.) to ensure that the scope of review is clear and investors follow the pertinent (notification and application) procedures. It is noteworthy that most ISCMs target investments that give the *foreign* acquirer some sort of *control* over the target.

However, the centerpiece of any ISCM is usually the *national security* standard (or a semantical equivalent). Foreign investments imperiling national security are what ISCMs aim (or purport) to prevent, at least in liberal economies. In ISCMs' legal minutiae, this term is never exhaustively defined, sometimes enigmatic and in many cases not revisable by adjudicative bodies. Thereby, it is subject to wide, perhaps infinite administrative discretion.

This may sound puzzling. One would naively expect this decisive criterion to incarnate the whole purpose of ISCMs in a clearcut fashion. Not quite: CFIUS has been called a "church without a bible" mocking the ambiguity of its crucial criterion of review—and it is fair to extend this aphorism to ISCMs in general. National security has been construed in such broadness to include even *economic security* of states. And although studies by Moran and others have compiled CFIUS casuistry and deduced from it what–in practice–national security means, a justiciable definition has neither been the fruit of these studies nor of pertinent OECD guidelines. The Draft Proposal does not seem to curb these tendencies, as it refers to *security and public order* and provides a (nonexhaustive) catalogue of factors which may be taken into account when determining whether they are affected.

Perhaps even more surprising, the quest for a justiciable definition of national security is no issue lain into the hands of adjudicators, who are accustomed to vague legal terms (and capable of substantiating them). On the contrary, national security is often not justiciable at all by the competent adjudicative bodies. This is true for CFIUS, as *Ralls* reaffirmed, and for many BITs, which usually contain a security exception clause loosely inspired by the GATT. To be sure, EU law would appear to offer protection either through the freedom of establishment (Art. 49 TFEU) or the free movement of capital (Art. 63 TFEU) and a meaningful casuistry of what *public policy* and *security* means. But if the CJEU were to transplant its somewhat quixotic reasoning developed in the context of direct taxes to ISCMs, then this protection would be illusory. This is because ISCMs target *controlling investments* by *thirdstate nationals*, which—according to the CJEU's settled doctrine—possibly enjoy no protection by fundamental freedoms at all, since they do not fall into the personal scope of the freedom of establishment

and the free movement of capital only applies to *portfolio,* i.e. noncontrolling investments. In addition, whenever an acquisition of defense sector companies stands to reason, Art. 346 TFEU gives member states additional leeway to protect *essential security interests*.

To sum up**,** legal redress against ISCM decisions is significantly limited from practical and legal points of view. In this regard, radical change is not to be expected from the Draft Proposal, whose only reference to legal redress ("*Foreign investors and undertakings concerned shall have the possibility to seek recourse against screening decisions of the national authorities.*" [Art. 3 (5) Draft Proposal]) leaves much room for interpretation.

Effective legal redress for thirdstate investors is a prerequisite for *legal certainty*, which is held dear by the Draft Proposal. It could also reduce suspicions of ISCMs being protectionist instruments against whoever turns out to be the latest "economic enemy". And while it is understandable that sovereign states are eager to retain matters of national security where they can (cf. Art. 4 (2) TEU), it can be questioned whether a liberal, open economy is really able to say (without blushing) that an investment imperils national security for the sole reason that the investor is Chinese. Giving ISCMs this sort of power, unrestrained by judicial review, is questionable, all the more during times in which economic policy is increasingly subjected to political polemics and even populism.

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